

SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

125 Broad Street
New York, NY 10004-2498

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May 20, 2013

MetLife, Inc.,
200 Park Avenue,
New York, New York 10280.

Attention: Ricardo Anzaldúa, Executive Vice President and General Counsel

Re: Application of Section 171 of the Dodd-Frank Act to Nonbank
Financial Companies Designated for Supervision by the Federal
Reserve Board

Ladies and Gentlemen:

You have asked whether the Board of Governors of the Federal Reserve System (the “Board”) has flexibility as to how it will apply the minimum capital requirements of Section 171 (“Section 171”)¹ of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)² to nonbank financial companies primarily engaged in the insurance business that are designated for supervision by the Board under Section 113 of Dodd-Frank (“Designated Insurance Companies”). Specifically, we address whether the Board may tailor the minimum capital requirements for Designated Insurance Companies that it develops pursuant to Section 171 to take into account the unique nature of the insurance business, its significantly different risk profile from that of the business of banking and the extensive and proven risk-based capital regime that already applies to the insurance industry under state insurance law (i.e., the National Association of Insurance Commissioners’ Risk-Based Capital (“RBC”) framework). As you know, members of Congress and the insurance industry have expressed concern that, if the implementation of Section 171 (also known as the “Collins Amendment” after its

¹ Codified at 12 U.S.C. § 5371.

² Pub. L. No. 111-203 (2010).

author, Senator Susan Collins) were not tailored appropriately by the Board, the negative impact on insurance companies and on U.S. insurance consumers would be unintended and could be severe.

A. Summary

We believe that the Board has broad flexibility in the way it develops and applies the minimum capital requirements under Section 171 for Designated Insurance Companies and other nonbank financial companies supervised by the Board (together with Designated Insurance Companies, “Designated NBFCs”), for three primary reasons.

First, Section 171 is only one part of the unified statutory scheme established by Congress in Title I, Subtitle C (“Subtitle C”) of Dodd-Frank for the federal regulation and supervision of Designated NBFCs by the Board. Therefore, when interpreting and applying Section 171, the Board must do so in the context of, and consistent with, Subtitle C’s mandate of tailored design and application with respect to the capital and other prudential requirements that the Board has broad authority to develop for and apply to Designated NBFCs. Subtitle C specifically requires the Board to take into account the differences between bank holding companies (“BHCs”) and Designated NBFCs and to adapt the capital and prudential standards applicable to Designated NBFCs appropriately in light of their primary business line or other activities.³ In addition, Subtitle C mandates that the Board avoid imposing duplicative requirements on Designated NBFCs.⁴ Therefore, if the Board were to determine that the application of bank-centric capital requirements developed under Section 171 for banking organizations would be duplicative of the RBC framework already applied to Designated Insurance Companies (or some multiple thereof),⁵ the Board would be required to take appropriate actions to avoid that duplication.

³ At Section 165 of Dodd-Frank (“Section 165”) (codified at 12 U.S.C. § 5365).

⁴ At Section 169 of Dodd-Frank (“Section 169”) (codified at 12 U.S.C. § 5369).

⁵ Like the framework for insured depository institutions, the RBC framework requires an insurance company to hold a certain level of minimum regulatory capital in order to satisfy the minimum regulatory requirements and provides formulae for the calculation of these amounts. The “Authorized Control Level” is the amount of required capital for an insurance company below which the state insurance regulator is authorized to take control of an insurer. The “Company Action Level” (which is 200% of the Authorized Control Level) is the amount of required capital for an insurance company below which company-level action to restore capital levels is triggered. Generally, insurance companies are required to operate at an RBC ratio in excess of 100% of Company Action Level. As a matter of financial strength ratings and market acceptance, life insurers are expected to operate at an RBC ratio in excess of 350% of the Company Action Level (i.e., 700% of the Authorized Control Level). The Board is

Second, although Section 171 does provide certain baseline guidance for minimum capital requirements, it is not prescriptive as to how that guidance should be developed and applied by the Board and the other federal banking agencies (together with the Board, the “Agencies”), particularly for Designated NBFCs in light of the other mandates of Subtitle C. This absence of prescriptive direction opens Section 171 to broad interpretation, and provides the Board clear authority to develop and apply the minimum capital requirements required for Designated Insurance Companies under Section 171 in a tailored, flexible and nonduplicative manner, as Congress expressly instructed the Board to do in Subtitle C. Such an interpretative approach is reasonable and advances Congressional intent and the purpose of the statute. Indeed, the Board and the other Agencies have already confirmed this authority, and have proposed to use it, to tailor the capital framework designed for insured depository institutions to account for the substantially different nature and risk profile of insurance assets and operations. Moreover, the Board has clear authority under the terms of Section 171 to adopt a different capital framework for Designated Insurance Companies so long as that framework is no less stringent than that applied to insured depository institutions. A capital framework for Designated Insurance Companies does not need to be identical to that applied to insured depository institutions in order to be no “less stringent”, particularly given the different nature and risk profile of insurance company operations.

Third, as expressed in numerous letters to the Board and the other Agencies from members of Congress, including from Senator Collins, Congress intended that the capital and leverage requirements mandated by Section 171 be tailored in this fashion for insurance companies and that such requirements not supplant the existing capital requirements applied to insurance companies under state insurance law. This is entirely reasonable, indeed almost compelled, when considered in the context of the well-established and long-standing federal policy not to interfere with the state regulation of the business of insurance, as mandated by Congress in the McCarran-Ferguson Act of 1945 and in the Bank Holding Company Act of 1956 (the “BHC Act”).⁶

There are also important public policy reasons for the Board to exercise the significant flexibility Congress has provided it in order to avoid the serious negative consequences to the U.S. economy and to U.S. consumers that could result if a capital regime designed for banking organizations were applied to Designated Insurance Companies.

authorized to evaluate whether some multiple of the Authorized Control Level would make the RBC framework at least as stringent as and, therefore, duplicative of, the bank capital framework applied to insured depository institutions, which, in the case of the largest institutions, requires the maintenance of capital levels above the relevant minima.

⁶ See 15 U.S.C. § 1012(b) and 12 U.S.C. § 1844(c)(3).

B. Statutory Background

Subtitle C establishes a new, comprehensive framework for the federal supervision of systemically important BHCs and Designated NBFCs in order to prevent or mitigate risks to the financial stability of the United States arising from such institutions. The core elements of that framework are contained in Section 165 of Subtitle C, which requires the Board to develop prudential standards appropriate for the risks presented by these systemically important institutions, including risk-based capital requirements and leverage limits, and grants the Board broad authority to do so.

In developing these standards, Section 165 requires the Board to take into account the differences between BHCs and Designated NBFCs based on, among other things, whether the Designated NBFC controls an insured depository institution, the degree to which the institution is already regulated by a primary financial regulator, the importance of the Designated NBFC as a source of credit, the amount and nature of the Designated NBFC's financial assets, the nature of the Designated NBFC's assets (including its reliance of short-term funding), any nonfinancial activities or affiliates and other appropriate risk-related factors.⁷ The Board is authorized to differentiate among companies individually or by category based on their capital structure, riskiness, complexity, financial activities, size and any other risk-related factors the Board deems appropriate.⁸ The Board is also required to adapt these standards appropriately in light of the institution's predominant line of business or other activities, for which particular standards may not be appropriate.⁹

Section 171, another section of Subtitle C, requires the Agencies to establish minimum risk-based capital and leverage requirements on a consolidated basis for insured depository institutions, BHCs, savings and loan holding companies ("SLHCs"), and Designated NBFCs (together, "Covered Institutions"). There are two elements that these requirements must satisfy: (i) they may not be "less than the generally applicable risk-based capital requirements" applied to insured depository institutions at any given time, which are to serve as a "floor"; and (ii) they may not be "quantitatively lower than the generally applicable risk-based capital requirements"

⁷ Section 165(b)(3)(A). Some of these mandatory considerations are found in Section 113(a) of Dodd-Frank, which is expressly incorporated in Section 165(B)(3)(A)(i).

⁸ Section 165(a)(2)(A).

⁹ Section 165(b)(3)(D).

applied to insured depository institutions as of the date of enactment of Dodd-Frank, July 21, 2010 (emphasis added).¹⁰

Section 168 of Dodd-Frank provides the Board with rulemaking authority to implement Subtitle C, and, significantly, Section 169 requires the Board in doing so to take any action it deems appropriate to avoid imposing requirements that are duplicative of requirements applicable to BHCs and Designated NBFCs under other provisions of law.

C. The Board has Broad Flexibility in the Manner that It Develops and Applies the Minimum Capital Requirements under Section 171 for Designated Insurance Companies

1. *Section 171 is Part of a Unified Statutory Scheme and Must Be Interpreted Holistically with That Scheme*

As noted, Section 171 is only one part of the comprehensive statutory framework set forth in Subtitle C for the federal supervision and regulation of systemically important banking organizations and nonbank financial companies and, indeed, is inherently related to the enhanced capital requirements imposed on Designated NBFCs by Section 165. Accordingly, as the Supreme Court has made clear in other contexts, Section 171 must be read holistically and harmoniously with the rest of the statutory scheme of which it is a part:

“It is a ‘fundamental canon of statutory construction that words of a statute must be read in their context and with a view to their place in the overall statutory scheme.’ . . . A court must therefore interpret the statute ‘as a symmetrical and coherent regulatory scheme’. . . and ‘fit, if possible, all parts into an harmonious whole’”¹¹

¹⁰ Section 171(b)(2). Section 171(b)(1) of Dodd-Frank imposes the same requirement with respect to the leverage capital requirement.

¹¹ FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) (citations omitted). See also Conroy v. Aniskoff, 507 U.S. 511, 515 (1993)) (Looking to the “text and structure of the [statute] as a whole” and following “the cardinal rule that a statute is to be read as a whole . . . since the meaning of statutory language, plain or not, depends on context.”).

Recognizing this principle, the Board and the other Agencies have stated:

the relationship between the requirements of section 171 and other aspects of [Dodd-Frank], including section 165, must be considered carefully and . . . all aspects of [Dodd-Frank] should be implemented so as to avoid imposing conflicting or inconsistent regulatory capital requirements.¹²

This basic rule of statutory construction becomes even more compelling when, as with Section 171, the Board is implementing a statute that both lacks substantial detail as to how its requirements will be implemented and is subject to broad interpretation (see Part C.2 of this Letter).

Read as a whole, Subtitle C demonstrates that Congress not only intended that the Board have the flexibility, but required the Board, to adapt and tailor appropriately the capital and prudential standards to be developed under Subtitle C for Designated NBFCs. Section 165 is replete with Congressional mandates that the Board develop and apply those standards for Designated NBFCs on a basis that takes into account their unique nature and the risks they present. For example, in developing and applying standards under Section 165, the Board is permitted (under the heading titled “Tailored Application”) to “differentiate among companies on an individual basis or by category”.¹³ In prescribing such standards, the Board is under an obligation to (“shall”) consider differences between Designated NBFCs and BHCs, including based on whether the Designated NBFC controls an insured depository institution, the degree to which the institution is already regulated by a primary financial regulator, the importance of the Designated NBFC as a source of credit, the amount and nature of the Designated NBFC’s financial assets, the nature of the Designated NBFC’s assets (including its reliance of short-term funding), any nonfinancial activities or affiliates and other appropriate risk-related factors.¹⁴ Moreover, Section 165(b) explicitly requires the Board “to adapt the required standards appropriately in light of any predominant line of business . . . or other activities for which particular standards may not be appropriate.”¹⁵

¹² 76 Fed. Reg. 37620, 37626 (June 28, 2011).

¹³ Section 165(a)(2)(A).

¹⁴ Section 165(b)(3)(A).

¹⁵ Section 165(b)(3)(D).

These conclusions as to flexibility and differentiation are reinforced by other portions of Section 165 that make clear that Congress was concerned about the development and application of prudential standards where it may be inappropriate or duplicative. For example, the Board must consult with the member or members of the Financial Stability Oversight Council (“FSOC”), such as the state insurance commissioner representative, that supervise any functionally regulated subsidiary of a Designated NBFC that would be significantly impacted by the proposed prudential standards. The Board is also required by Section 169 to avoid duplicating requirements imposed on such an institution by other provisions of law.¹⁶

Three additional statutory considerations further demonstrate that Subtitle C must be read as a holistic and harmonious whole and that the application of Section 171 to Designated NBFCs, therefore, must be governed by the requirements of Section 165, unless the specific language of Section 171 provides otherwise.

First, Section 171 is freestanding with respect to BHCs, SLHCs and insured depository institutions, because they are already subject to the rulemaking and supervisory authority of the Agencies irrespective of Dodd-Frank. In contrast, Section 171 cannot be freestanding with respect to Designated NBFCs because Section 171 does not, by itself, grant the Board any rulemaking or supervisory authority with respect to them. The source of the Board’s authority to issue regulations establishing capital requirements for Designated NBFCs under both Section 171 and Section 165 is provided for separately in Section 168 of Dodd-Frank. The fact that both provisions can only be implemented by relying on Section 168 inherently links them and demonstrates that Congress intended all the provisions of Subtitle C, including Section 171 and Section 165, to function as a unified, cohesive statutory scheme, which can only be accomplished by construing the provisions of Subtitle C holistically.

Second, both Section 165 and Section 171 require the Board to prescribe risk-based capital requirements and leverage limits for Designated NBFCs. The Board must, therefore, determine how to reconcile these overlapping requirements. Although Section 171 more specifically addresses the types of capital requirements that must be developed by the Board for Designated NBFCs (i.e., the “less than” and “quantitatively lower than” requirements related to minimum risk-based capital and leverage), Section 165 more specifically addresses how the capital requirements are to be developed for and applied to Designated NBFCs (i.e., in a tailored, flexible and nonduplicative manner)—an area where Section 171 is silent.

Because Congress more specifically defined the methodology for the development of risk-based capital requirements and leverage limits to Designated NBFCs

¹⁶ Section 165(b)(4) and Section 169.

in Section 165, the development of rules to implement Section 171 to Designated NBFCs must be governed by the tailored and flexible approach mandated by Section 165. Indeed, it would turn the statute on its head to interpret Section 171 as being less flexible or less tailored in its application than Section 165 because Congress intended the standards issued pursuant to Section 165 to be “more stringent” than those generally applicable to all BHCs, SLHCs and insured depository institutions, including under Section 171. Congress clearly expected that the Board would be able to satisfy this “more stringent” requirement with a tailored, flexible and nonduplicative regime.

Furthermore, there is no indication in Section 171 itself or elsewhere in Subtitle C that Section 171 was intended to “override” the basic instructions Congress gave the Board in Section 165 for the development and application of capital and prudential standards for Designated NBFCs. The Board, therefore, must look to Section 165 when determining how to apply Section 171 to Designated NBFCs and particularly to Designated Insurance Companies.

Third, the authority of the Board under both Section 165 and Section 171 is subject to the direction in Section 169, which requires and authorizes the Board to “take any action that [it] deems appropriate to avoid imposing requirements under [Subtitle C] that are duplicative of requirements applicable to bank holding companies and nonbank financial companies under other provisions of law.” Therefore, even if Section 171 unambiguously required the application of bank capital requirements to the insurance assets and operations of all Covered Institutions (which it does not), the Board would be required under Section 169 to take any actions it deemed appropriate to avoid imposing those requirements if it determined that they were duplicative of the RBC framework (or some multiple thereof).¹⁷

¹⁷ This result is also consistent with the requirement under Section 165(b)(1)(A)(i) that the Board “shall” apply to a Designated NBFC standards different from the risk-based capital requirements otherwise established under Section 165 if the Board determines (in consultation with FSOC) that such risk-based capital requirements are not appropriate for a Designated NBFC because of its activities or structure. Such different standards must result in “similarly stringent risk controls”. Accordingly, if the Board were to find that the bank-centric risk-based capital rules were not appropriate for Designated Insurance Companies, the Board is required under Section 165 to apply different standards than those otherwise required under Section 165. If the Board determined that the RBC framework would result in “similarly stringent risk controls”, it would be authorized to apply that framework to Designated Insurance Companies in lieu of the bank-centric requirements.

2. *Section 171 is Subject to Broad Interpretation and Does Not Specify How the Minimum Capital Requirements of Section 171 Should Be Developed for, or Applied to, Designated NBFCs*

a. Section 171 is Subject to Broad Interpretation

As noted, Section 171 requires the Agencies to establish minimum risk-based capital and leverage requirements for all banking organizations and Designated NBFCs. It is clear that Congress intended these to be not “less than” those applied to insured depository institutions at any particular point in time, nor “quantitatively lower than” those applied to insured depository institutions on July 21, 2010. What is not clear is precisely what the terms “less than” and “quantitatively lower than” refer to, because Section 171’s reference to the term “generally applicable risk-based capital requirements” is not prescriptive and is subject to broad interpretation.

Although Section 171(a)(2) of Dodd-Frank provides a definition of “generally applicable risk-based capital requirements,”¹⁸ that definition only refers generally to the prompt corrective action capital requirements established by the Agencies (the “Bank Capital Rules”), including “the regulatory capital components in the numerator of those capital requirements, the risk-weighted assets in the denominator of those capital requirements, and the required ratio of the numerator to the denominator.” These “requirements” have both qualitative and quantitative components. For example, the definition of a capital component and the methodology for calculating a capital or leverage ratio are qualitative, whereas the numerical minimum values for those ratios (e.g., 4%, 8% and 3%) are quantitative. Thus, the Board and the other Agencies have broad interpretive authority to define what Section 171 means when it states that a capital framework cannot be “less than” nor “quantitatively lower than” the Bank Capital Rules, which are comprised of multiple qualitative and quantitative components. Given the statute’s lack of prescriptive direction and detail, the Board is authorized and has broad

¹⁸ The term “generally applicable risk-based capital requirements” means:

(A) the risk-based capital requirements, as established by the appropriate Federal banking agencies to apply to insured depository institutions under the prompt corrective action regulations implementing section 38 of the Federal Deposit Insurance Act, regardless of total consolidated asset size or foreign financial exposure; and

(B) includes the regulatory capital components in the numerator of those capital requirements, the risk-weighted assets in the denominator of those capital requirements, and the required ratio of the numerator to the denominator.

flexibility to choose a reasonable interpretation of Section 171's requirements consistent with the purpose of the statute as a whole.

The legislative history of Section 171 provides some guidance as to how best to reconcile both the qualitative and quantitative elements. During Congressional debates, Senator Collins discussed and entered into the Congressional Record a letter from then-Chairman of the FDIC, Sheila Bair, who was a major proponent of Section 171:

If, in the future, bank holding companies are to become sources of financial stability for insured banks, then they cannot operate under consolidated capital requirements that are numerically lower and qualitatively less stringent than those applying to insured banks. This amendment would address this issue by requiring bank holding companies to operate under capital standards at least as stringent as those applying to banks.¹⁹

Using this statement as a guide, Section 171 could be interpreted reasonably to mean that a capital framework applied to a Covered Institution pursuant to Section 171 may not be qualitatively less stringent than those applied to insured depository institutions at any particular time, and may not be quantitatively lower than the numerical risk-based capital ratios²⁰ applied to insured depository institutions as of July 21, 2010.

b. Lack of Guidance in Section 171 as to How to Develop and Apply the Minimum Capital Requirement for Designated Insurance Companies

Even after the Board exercises its broad authority to interpret Section 171's requirements, it must determine how to implement those requirements. In that regard, Section 171 is silent. The statute does not specify how the Agencies are to determine whether any particular capital framework meets the not "less than" nor "quantitatively lower than" requirements, what elements of the capital frameworks they

¹⁹ 156 Cong. Rec. S3460 (daily ed. May 10, 2010) (Exhibit 1, letter from Chairman Sheila C. Bair to Sen. Collins).

²⁰ I.e., under the current Bank Capital Rules, 8% qualifying total capital to risk-weighted assets, at least 4% of which must be Tier 1 capital, for an "adequately capitalized" institution.

are to consider or what methods they are to use to conduct any of this analysis.²¹ Of particular importance, Section 171 does address the risk weighting of assets that Designated NBFCs hold, but that insured depository institutions either do not, hold only minimally or that are funded in a different way.²² The Supreme Court has made clear that, in these circumstances, where “the subject matter . . . is technical, complex, and dynamic . . . as a general rule, agencies have authority to fill gaps where statutes are silent.”²³

As the Board and the other Agencies have recognized, Section 171 does not mandate that the capital requirements developed for and imposed on Covered Institutions remain static, and certainly, as stated by the Agencies, “section 171 does not require a ‘permanent Basel-I based floor’”²⁴ Significantly, Section 171 also does not mandate that the capital framework must be the same for all Covered Institutions or categories of Covered Institutions. Otherwise, Congress could have made this explicit by stating that the capital requirements must be the “same as” those applied to insured depository institutions, rather than using the phrase “less than”.

Congress did not impose either of these requirements. Instead, Congress mandated only that the requirements developed for and applied to a Covered Institution under Section 171 be not “less than” those applied to insured depository institutions at any given time, nor “quantitatively lower than” the bank capital and leverage ratios in effect on July 21, 2010. In other words, Congress may have mandated a quantitative “floor” with respect to the minimum risk-based capital and leverage ratios to be adapted by the Board and the other Agencies, but it did not mandate how the Board and other Agencies define or calculate the constituent elements of that floor. Congress, quite appropriately, left the details for the development of the required capital framework to the Agencies, and specifically to the Board in the case of Designated Insurance Companies and other Designated NBFCs. As mentioned, this delegation is particularly pronounced in the case of assets that generally are not held by insured depository institutions or that are funded in a different manner.

²¹ For example, the Agencies have previously requested comment as to how the “quantitatively lower than” analysis should be conducted (75 Fed. Reg. 82317, 82320 (Dec. 10, 2010)).

²² As stated by the Board: “The Board will be supervising these institutions for the first time and expects that there will be cases when it needs to evaluate the risk-based capital treatment of specific exposures not typically held by depository institutions, and that do not have a specific risk weight under the generally applicable risk-based capital requirements.” *Id.* at 82319.

²³ Nat’l Cable & Telecommunications Ass’n, Inc. v. Gulf Power Co., 534 U.S. 327, 339 (2002).

²⁴ 76 Fed. Reg. 37620, 37626 (June 28, 2011).

The only guidance Congress provided with respect to the development of capital and other prudential requirements to Designated NBFCs is found in other parts of Subtitle C, such as Section 165 and Section 169. As noted above, the Board and the other Agencies have stated that Section 171 and Section 165, as well as the other provisions of Dodd-Frank, must be considered together to avoid imposing conflicting or inconsistent regulatory capital requirements.²⁵

In addition, in the proposed rule to create “standardized” capital rules for banking organizations (the “Proposed Rule”),²⁶ the Board and the other Agencies already have specifically recognized and exercised their authority to tailor the elements of the Bank Capital Rules to accommodate insurance company assets.²⁷ For example, with respect to separate non-guaranteed accounts, the Agencies noted that “[u]nder the general risk-based capital rules, assets held in separate accounts are assigned to risk-weight categories based on the risk weight of the underlying assets.” Under the Proposed Rule, these accounts would receive a risk weight of 0% provided that certain criteria are met.

The Proposed Rule, however, addresses only some of the significant concerns that would be raised if the Bank Capital Rules were applied to insurance company subsidiaries. The authority that the Agencies have exercised in the Proposed Rule is not, and need not be, limited to addressing a handful of capital elements but can be used more expansively to ensure that the capital framework applicable to insurance company operations is fully tailored to reflect their unique nature and risk profile.

c. The Board’s Broad Flexibility to Develop and Apply the Minimum Capital Requirements under Section 171 for Designated Insurance Companies

In light of the absence of prescriptive direction in Section 171, the Board, as does any Agency, has great flexibility with respect to how it applies the “less than” and “quantitatively lower than” requirements to a Covered Institution over which it has

²⁵ See note 12 and accompanying text.

²⁶ 77 Fed Reg. 52,888 (Aug. 30, 2012). Together with accompanying proposals to implement Basel III, the capital requirements set forth in the Proposed Rule would be the “generally applicable risk-based capital requirements” under Section 171 for BHCs, SLHCs and insured depository institutions. The Proposed Rule did not state expressly that it would apply to Designated NBFCs.

²⁷ Some of these changes could be characterized as adapting the Bank Capital Rules to assets that were not previously relevant to the Bank Capital Rules (such the risk weight for policy loans), but others (such as the risk weight for separate accounts) represent a substantive change in the Bank Capital Rules.

supervisory and rulemaking authority. In the Proposed Rule, the Board and the other Agencies have used this flexibility, for example, by applying substantially lower risk weights to certain traditional insurance company assets than would be applied to those assets if held by an insured depository institution and by exempting some arrangements altogether.²⁸ This flexibility is, however, even greater as the Board develops rules under Section 171 for Designated Insurance Companies, given the requirements of the other provisions of Subtitle C which mandate that the Board's capital requirements developed for Designated Insurance Companies be tailored, flexible and nonduplicative.

Consistent with the flexibility afforded to and recognized by the Board under Subtitle C, the Board is authorized, for example, to do any of the following:

i. not apply the Bank Capital Rules to insurance company subsidiaries that are subject to the RBC framework (which recognizes and accounts for the differences between the risk and risk coverage ability of insurance companies and banking organizations), as long as the Board determines that the RBC framework (or some multiple thereof specified by the Board) is at least as stringent as the Bank Capital Rules;²⁹

ii. alter the treatment of the asset and capital elements of the Bank Capital Rules for insurance company subsidiaries based on the fundamental and significant differences in risks of those elements when funded by an insurance company, versus when funded by an insured depository institution or an insured depository institution holding company; or

iii. apply an entirely separate capital framework to Designated Insurance Companies, whether based on RBC or otherwise, if the Board found that the separate capital framework is at least as stringent as the Bank Capital Rules.

Each of these three approaches recognizes that, as noted, Section 171 permits the application of a minimum capital framework different from that specified in the Bank Capital Rules to all or part of a Covered Institution's operations so long as that different capital framework is at least as stringent as that applied to insured depository institutions. In the case of Designated Insurance Companies, the RBC framework, to which they are already subject, accounts for the entirely different risk profile of an

²⁸ See note 26 and accompanying text.

²⁹ The Board could satisfy Section 171's requirement of a capital regime that applies on a consolidated basis by combining this approach with the application of the Bank Capital Rules to the holding company and its other subsidiaries.

insurance company, as compared to a banking organization.³⁰ While such a framework could require less absolute capital than a comparably sized bank, that does not make the framework less stringent given the substantially greater stability of insurance company liability structures and concomitant ability to retain assets over a longer time horizon.³¹ Given this important distinction, the Board could clearly find that the RBC framework (or some multiple thereof) is at least as stringent³² as the Bank Capital Rules.

*3. Congressional Intent and the Well-Established Limitation on
Federal Regulation of Insurance Demonstrate that the
Development of Rules under, and Application of, Section 171 for
Designated Insurance Companies Should be Tailored and
Nonduplicative*

Interpreting Section 171 to allow the tailored development and application of minimum capital requirements for Designated Insurance Companies is not only called for under fundamental canons of statutory construction, but would be consistent both with Congressional intent and with the long-held policy and legal prohibition on federal interference with state insurance regulation.

³⁰ Application of the Bank Capital Rules to insurance companies would produce many inappropriate distortions. As one of many examples, to match their long-term liabilities, insurers often hold significantly greater portions of their assets in the form of long-term available-for-sale securities than do banks. Including unrealized gains and losses on these securities in the calculation of Tier 1 common equity would generate substantial volatility in the capital levels of these insurers as interest rates fluctuate, and would require them to hold excess capital to account for this volatility. Such capital treatment would be highly inappropriate, as such gains and losses resulting from temporary fluctuations in interest rates are unlikely to be realized; insurers generally hold these long-dated assets to match their long-term liabilities and do not face policyholder runs that could force them to sell the assets prematurely.

³¹ This is the direct result of the differences between the nature of bank liabilities, which are shorter-term and subject to depositor runs, and insurance company liabilities, which are longer-term and generally not subject to policyholder runs.

³² “Stringency” is obviously a qualitative and broad concept which affords the Board substantial flexibility. As noted above, the stringency requirement does not require the Board to apply a capital framework to Designated Insurance Companies that is identical to the framework applied to insured depository institutions.

As discussed at length in a letter to the Board by a group of nine law firms,³³ numerous members of Congress have expressed serious concerns to the Agencies, in response to the Proposed Rule, that Congress' intent with respect to the application of Section 171 to insurance companies is not being effected. These members of Congress make clear that Congress did not intend the capital requirements discussed in Section 171 to supplant existing state insurance capital regimes.³⁴ Another letter from a bipartisan group of members of Congress to Chairman Bernanke made the point even more specifically: "[W]e ask that the rules consistently reflect congressional intent by incorporating the state risk-based capital system and applying capital standards that accommodate the existing framework for companies engaged in the business of insurance."³⁵

Significantly, Senator Collins herself stated that the Proposed Rule should not, contrary to the intent of Congress in enacting Section 171, "supplant prudential state-based insurance regulation with a bank-centric capital regime. Instead, consideration should be given to the distinctions between banks and insurance companies....I believe it is consistent with my amendment that these distinctions be recognized in the final rule."³⁶

As courts have recognized, although post-enactment statements by members of Congress are not dispositive, when interpreting a statute, agencies "can and should consider policy input from a wide variety of sources, including the views of private citizens, industry groups, non-governmental organizations, legal commentators, and, most certainly, Congress."³⁷ Certainly the statements of Senator Collins, as the author, sponsor and primary proponent of Section 171, should be given great weight

³³ Letter from Arnold & Porter LLP, Debevoise & Plimpton LLP, Dechert LLP, Gibson, Dunn & Crutcher LLP, Paul Hastings LLP, Shearman & Sterling LLP, Venable LLP, Wachtell, Lipton, Rosen & Katz and Winston & Strawn LLP to Scott G. Alvarez, General Counsel of the Board of Governors of the Federal Reserve System, at 10–13 (March 20, 2013).

³⁴ "While we recognize that the Dodd-Frank Act directs the federal banking agencies to establish minimum capital standards on a consolidated basis, Congress did not intend for federal regulators to discard the state risk-based capital system in favor of a banking capital regime." Letter to Ben. S. Bernanke, Martin J. Gruenberg and Thomas J. Curry from 24 U.S. Senators (Oct. 17, 2012).

³⁵ Letter to Ben Bernanke from 33 members of Congress (Dec. 11, 2012).

³⁶ Letter to Ben S. Bernanke, Martin J. Gruenberg and Thomas J. Curry from Senator Susan Collins (Nov. 26, 2012).

³⁷ PDK Laboratories, Inc. v. DEA, 438 F.3d 1184, 1192 (D.C. Cir. 2006).

when determining how to interpret and implement Section 171 to carry out Congressional intent.

Congress's intent that Section 171 not supplant the existing capital framework applied under state law to insurance companies, as reflected in the statements of Senator Collins and the other members of Congress, is also consistent with the well-established and codified federal policy, that federal agencies are not to interfere with the state regulation of insurance. This policy is reflected in the McCarran-Ferguson Act of 1945, which codified federal deference to states in the regulation of the business of insurance and which states:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance....
(emphasis added)³⁸

This federal policy of deference to state regulation of insurance is also expressly reflected in the BHC Act, which forbids the Board "by regulation, guideline, order, or otherwise" from imposing "any capital or capital adequacy rules, guidelines, standards, or requirements on any functionally regulated subsidiary of a bank holding company that . . . is in compliance with the applicable capital requirements of its . . . State insurance authority."³⁹

The imposition of bank capital requirements to a company whose assets are overwhelmingly housed in state-regulated insurance company subsidiaries, and which does not engage in the business of banking, is plainly inconsistent with this long-standing federal policy.

D. Conclusion

As discussed above, we believe that implementing Section 171 without due regard for the unique nature of the insurance business would be directly violative of Congress' intent, as expressed in Subtitle C itself and subsequent communications by members of Congress to the Agencies. Failure to give such due regard would potentially


³⁸ 15 U.S.C. § 1012(b). It would be a hyper-technical reading of the McCarran-Ferguson Act to argue that it does not apply to the regulation of a holding company when the impact is virtually entirely on insurance operations.

³⁹ 12 U.S.C. § 1844(c)(3)(A).

result in the precise serious negative consequences for Designated Insurance Companies and U.S. consumers that Congress explicitly sought to avoid in several provisions of Subtitle C. Although the Board and the other Agencies have recognized, and have proposed to use, their flexibility in determining how to apply Section 171, an approach of applying the Bank Capital Rules to Designated Insurance Companies with only a limited number of modified capital elements does not go far enough to avoid these negative consequences. Such limited use of the broad flexibility the Board has been granted is not required and is indeed contrary to Congress's instructions to the Board throughout Subtitle C, as well as Congressional intent.

As described in this letter, the Board has the authority under Subtitle C to develop and apply the minimum capital requirements under Section 171 for Designated Insurance Companies in a manner that is tailored, flexible and nonduplicative. Indeed, we believe that such flexibility is mandated by Subtitle C and that, therefore, the Board must exercise it appropriately. This action would avoid the negative consequences discussed above while advancing the policy goals of Section 171 and Subtitle C, would effect Congressional intent and would respect the overarching federal policy expressed in the McCarran-Ferguson Act and the BHC Act that, absent a clear Congressional mandate otherwise, states are to regulate the business of insurance, not the federal government.

Very truly yours,

A handwritten signature in black ink, appearing to read "Rodgin CL", with a stylized flourish at the end.

H. Rodgin Cohen

cc: J. Virgil Mattingly
Sean M. Memon
Stephen M. Salley
(Sullivan & Cromwell LLP)